

MINUTE ITEM

This Calendar Item No. 17
was approved as Minute Item
No. 17 by the State Lands
Commission by a vote of 3
to 0 at its 3/22/84
meeting.

CALENDAR ITEM

17 4

3/22/84
PRC 4596
PRC 4597
Small/
Herring/
Willard

APPROVAL OF SETTLEMENT AGREEMENT
AND ROYALTY ACCOUNTING PROCEDURES
STATE LANDS COMMISSION

BACKGROUND:

The State has previously issued two geothermal leases to Union Oil Company, Thermal Power Company and Magma Geysers, Inc. The leases provide that the lessees shall pay the State a royalty of ten percent (10%) of the gross revenues received from the leases provide that the lessees shall pay the State a royalty of ten percent (10%) of the gross revenues received from the sale of steam.

A steam sales contract was entered into between Pacific Gas and Electric Company and the lessees. These contracts were previously approved by the Commission. Pursuant to paragraph 10 of the steam sales contracts, the lessees are paid for steam on the basis of net kilowatt hours produced by the electrical generating plants. The steam sales contracts provide that the lessees are obligated to dispose of effluent produced from steam condensation and provides additional consideration of a 0.5 mill per net kilowatt hour of electrical production as long as the lessees are disposing of the effluent.

In 1979, Public Resources Code Section 6921 was amended to allow the State to share in any profits which are realized from effluent re-injection operations.

CALENDAR PAGE	<u>75</u>
MINUTE PAGE	<u>555</u>

The audit staff completed an audit which indicated that the lessees could owe the State for money received pursuant to the 0.5 mill payment. The lessees were billed and a dispute arose regarding the interpretation of the sales contract and PRC Section 6921.

In order to avoid costly and time-consuming litigation concerning complex legal issues, staff commenced settlement negotiations with the lessees and have reached a proposed settlement which will avoid the need for expensive litigation.

The settlement essentially provides as follows:

1. The lessees will pay the State \$540,000.
2. For years commencing January 1, 1979, the parties have developed what is essentially a net profits accounting agreement (see Exhibit "3"). Revenue and expenses for effluent disposal operations shall be determined in accordance with these procedures.

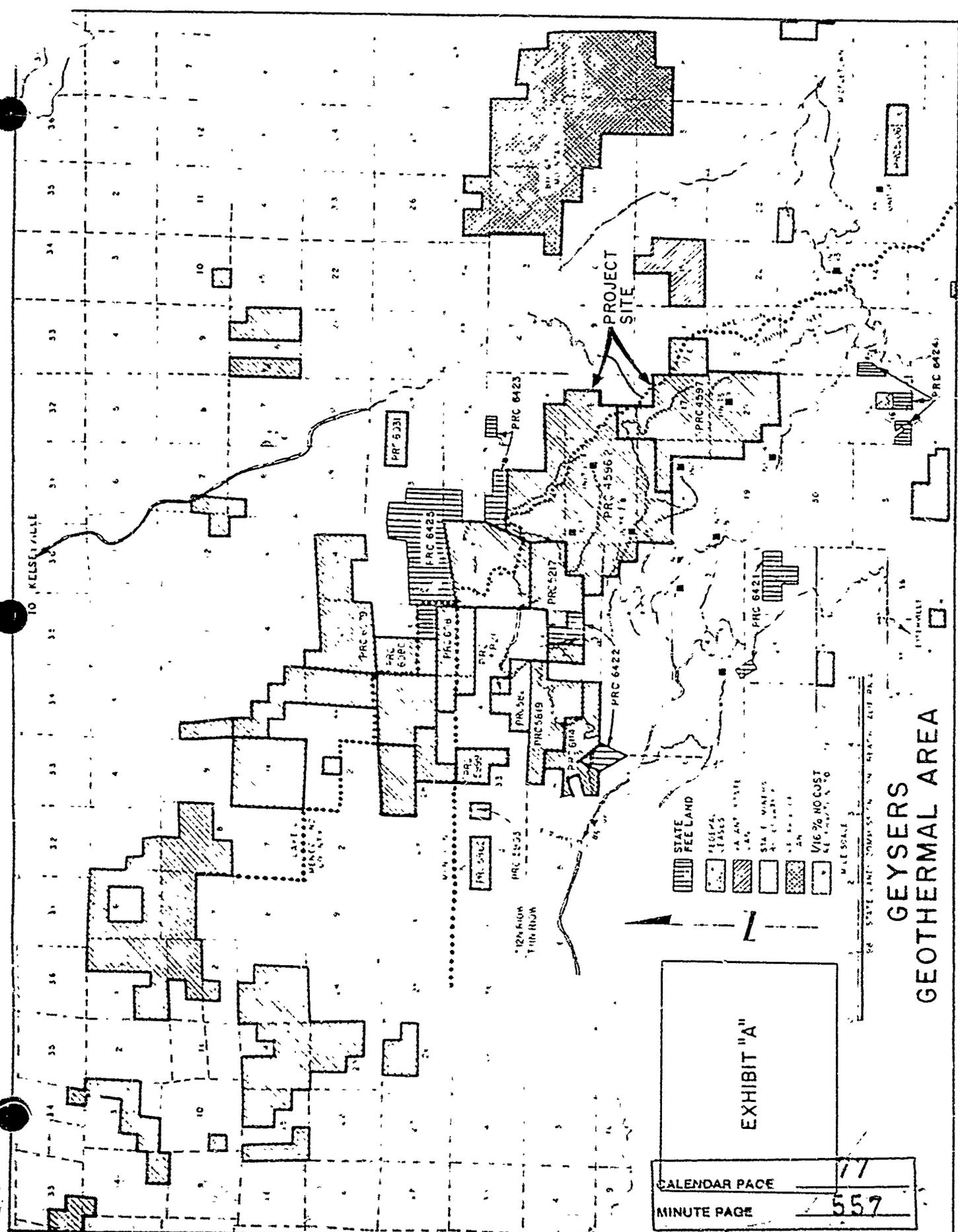
Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (14 Cal. Adm. Code 15061), the staff has determined that this activity is exempt from the requirements of the California Environmental Quality Act (CEQA) because the activity is not a "project" as defined by CEQA and the State CEQA Guidelines.

Authority: PRC 21065 and 14 Cal. Adm. 15378.

- EXHIBITS:
- A. Area "ap."
 3. Settlement Agreement and Accounting Procedures.

THE STAFF BELIEVES THAT THIS SETTLEMENT AGREEMENT IS IN THE BEST INTERESTS OF THE STATE AND RECOMMENDS THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CALIFORNIA ENVIRONMENTAL QUALITY ACT (CEQA) PURSUANT TO 14 CAL. ADM. CODE 15061, BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY PRC 21065 AND 14 CAL. ADM. CODE 15378.
2. APPROVE THE PROPOSED SETTLEMENT AGREEMENT AND ACCOUNTING PROCEDURES ATTACHED AS EXHIBIT "3", AND AUTHORIZE EXECUTION OF THE AGREEMENT.



**GEYSERS
GEOHERMAL AREA**

EXHIBIT "A"	
CALENDAR PAGE	17
MINUTE PAGE	557

- STATE FEE LAND
- GEOHERMAL LEASES
- CALIFORNIA STATE LAND
- STATE WATERS
- 1/16th NO COST LEASES

2 MILE SCALE
 64 STATE LAND COMMISSION IN HEAVY AND DARK

EXHIBIT "B"

SETTLEMENT AND ACCOUNTING AGREEMENT

FOR CONSIDERATION ON REVENUE

RECEIVED FOR EFFLUENT DISPOSAL OPERATIONS

This Agreement is entered into this ____ day of March, 1984 by and between the California State Lands Commission (hereinafter referred to as "Lessor") and Union Oil Company of California, Magma Geysers, Inc. and Thermal Power Company, (hereinafter referred to jointly as "Lessees");

W I T N E S S E T H

WHEREAS, pursuant to the provisions of Division 6 of the California Public Resources Code, Lessor and Lessees entered into, effective May 27, 1971, two geothermal leases known as PRC 4596 and 4597 (hereinafter referred to as "the leases"); and

WHEREAS, Lessees each have individual steam sales contracts (hereinafter referred to as "Sales Contracts") with Pacific Gas and Electric Company (hereinafter referred to as "PG&E") covering the geothermal resources developed and produced from the aforesaid leases, said Sales Contracts being, in pertinent part, identical as to the terms and conditions relevant to this agreement; and

CALENDAR PAGE	78
MINUTE PAGE	558

WHEREAS, California Public Resources Code Section 6921, as amended, was enacted effective January 1, 1979, empowering the Commission to charge a consideration for effluent disposal operations conducted by Lessees on State leases on the condition that the Lessees realize a profit on said disposal operations and that said consideration could not exceed the net profits or royalties payable under the lease; and

WHEREAS, the leases provide a royalty of ten percent (10%) on "gross revenues" received from the "sale" of steam produced from the leases; and

WHEREAS, the Sales Contracts impose an obligation upon Lessees to dispose of effluent resulting from steam condensation and provides additional consideration on the condition that said effluent disposal obligation be complied with by Lessees; and

WHEREAS, the additional consideration received by Lessees for effluent disposal is treated separately from the steam sales price, though both are calculated on the basis of net kilowatt hours; and

CALENDAR PAGE	79
MINUTE PAGE	559

WHEREAS, Lessees have developed and continue to develop a field-wide integrated effluent disposal system designed to efficiently reinject effluent in a manner that both properly disposes of effluent waste, possibly stimulating the geothermal reservoir(s) and avoids damage to said reservoir(s); and

WHEREAS, a dispute has arisen between Lessor and Lessees as to the proper operation and application of CPRC Section 6921, the Sales Contracts, and a mutually acceptable accounting procedure to determine whether a profit is actually being realized by Lessees for effluent disposal; and

WHEREAS, the Lessor and Lessees acknowledge that the dispute concerning the above-noted issues are of substantial complexity, and unless resolved, would result in costly and time-consuming litigation which Lessor and Lessees desire to avoid;

NOW THEREFORE, in consideration of the facts stated above, and the mutual covenants contained hereinbelow, the Lessor and Lessees hereby agree to resolve the above-stated dispute as follows:

CALENDAR PAGE	<u>80</u>
MINUTE PAGE	<u>560</u>

1. Lessor agrees that consideration received by Lessees for effluent disposal shall not be considered or treated as income subject to the royalty provisions of the leases.

2. In addition, as consideration for the covenants contained herein, Lessees shall, within fifteen (15) days of execution of this agreement by all parties and approval by the State Lands Commission, pay Lessor a one-time-only lump sum of Five Hundred and Forty Thousand dollars and No Cents (\$540,000).

3. For calendar years commencing January 1, 1979, the Lessor and Lessees further agree in order to determine future consideration to be paid to Lessor, that costs associated with effluent disposal shall be determined in accordance with an Accounting Procedure, attached hereto and incorporated by reference as though fully set out herein.

4. The Accounting Procedure accounts for costs and revenues from all electrical generating plants incorporated in the Lessees' effluent disposal

CALENDAR PAGE	81
EXHIBIT PAGE	561

system. Said Accounting Procedure for expenses and revenue relating to effluent disposal is not intended by the Lessor or Lessees to be inconsistent with, nor shall be construed to be inconsistent with, the provisions of Public Resources Code Section 6921. Because of the integrated effluent disposal system, revenue and expenses associated with effluent disposal operations not on the leases shall be considered revenue and expenses for the purpose of calculating proceeds attributable to effluent disposal operations on the leases to which the percentage factor set out in Exhibit A shall apply.

5. The covenants and payments made pursuant to this Agreement are conditioned upon the agreement by the Parties hereto that all disputes concerning proper calculation of consideration to be paid by Lessee for effluent disposal income are herein resolved, and that no additional consideration, amount, levy, percentage, or royalty shall be applied, either

CALENDAR PAGE	82
NUMERICAL PAGE	562

retroactively or prospectively, concerning effluent disposal income received by Lessees pursuant to said Sales Contracts, except as herein provided.

Date: _____
Executive Officer
State Lands Commission

Date: _____
Date of Commission
Authorization

Date: _____
Union Oil Company of
California

Date: _____
Thermal Power Company

Date: _____
Magma Geysers, Inc.

CALENDAR PAGE	53
MINUTE PAGE	563

Accounting Procedure attached to and
made a part of the Settlement and Accounting
Agreement for Royalty Payments,
State Geothermal Leases PRC's 4596 and 4597

Accounting Procedures
Effluent Disposal Operations
State Leases PRC's 4596.2 and 4597.2

I. General Provisions

A. Definitions:

"Leases" or "State Leases" shall mean the geothermal leases issued by the State Lands Commission, and known as PRC 4596 and PRC 4597.

"Commission" shall mean the California State Lands Commission.

"Lessees" shall mean the lessees of the Lease and their respective heirs, successors, and assigns.

CALENDAR PAGE	84
MINUTE PAGE	564

"Effluent" shall mean the condensable water and other chemicals contained therein resulting from the condensation of steam.

"Noneffluent" shall mean freshwater, runoff water, or other fluids not resulting from the condensation of steam.

"State steam" shall mean steam produced from the Leases.

"State Effluent Disposal Account" shall mean the account used to account for revenue received pursuant to paragraph 10(c) of the P. G. & E. steam sales contract and to which capital costs, special well repairs, direct expenses, indirect expenses and applicable overhead are debited as provided in these accounting procedures.

"Effluent Disposal Operations" shall mean those operations necessary for the disposal of effluent.

"Effluent Disposal Facilities" include injection wells, pumps, effluent pipes and lines, and pumps.

"First Level Supervisors" shall mean those employees whose primary function is the direct supervision of other employees and/or contract labor directly employed in Effluent Disposal Operations.

CALENDAR PAGE	85
MINUTE PAGE	505

"Technical Employees" shall mean those employees having special and specific engineering, geological or other professional skills, and whose primary function is the handling of specific operating conditions and problems for the benefit of Effluent Disposal Operations.

"Personal Expenses" shall mean travel and other reasonable reimbursable expenses of Lessee's employees necessary for Effluent Disposal Operations attributable to steam produced from the leases.

"Material" shall mean personal property, equipment or supplies acquired or held for use for Effluent Disposal Operations.

"Controllable Material" shall mean Material which at the time is so classified in a list agreed upon by the Lessees and State.

B. Purpose and Creation of Accounts

Lessees shall establish a special internal account concerning Effluent Disposal Operations called the "State Lease Effluent Disposal Account", (hereinafter sometimes referred to in these procedures as the "Account").

CALENDAR PAGE	36
MINUTE PAGE	566

II. MANAGEMENT OF ACCOUNTS

A. Allowable costs as provided in these procedures below, shall be debited to the State Effluent Disposal Account.

B. All revenue received by lessees from P.G.&E. pursuant to paragraph 10(c) of the sales contract shall be credited to the Account regardless of the location of the electrical generating plant from which such revenue was received.

C. After posting items A and B above, the credit balance if any, of the Account shall be determined. The credit balance remaining in the State Effluent Disposal Account will represent the net profits resulting from Effluent Disposal Operations. The debit balance in the State Effluent Disposal Account reflects an absence of profit (loss condition) in the conduct of Effluent Disposal Operations and shall be carried over to the following year. The State share shall be computed at the end of each year and that is the amount that will be carried forward.

D. The credit balance to be allocated to the State leases shall be determined by dividing the total kilowatt

CALENDAR PAGE	37
MINUTE PAGE	567

hours of the electrical generating plants serving as the basis of revenue pursuant to II B. above, into the total kilowatt hours attributable to State steam delivered from the leases. The amount owing as additional royalty to the State shall be the royalty rate percentage provided in the leases multiplied by the allocated credit balance in the State Effluent Disposal Account.

E. The amount owing as additional royalty to the State shall be paid once a year by March 20th of the following calendar year and shall be based on costs paid and revenue received as of December 31st for the previous year for which payment is to be made.

F. Interest and Penalty

1. Any payment which is not paid when due shall bear interest from its due date until paid at the rate of one and one-half percent (1 1/2%) per month of the unpaid balance.

2. Any payment which is not paid when due shall be subject to a penalty of five percent (5%) of the past-due amount.

3. Past-due payments include, but are not limited to, amounts which were not paid because of lessees'

CALENDAR PAGE	568
MINUTE PAGE	568

unreasonable use of inaccurate information, unreasonable errors in the computations themselves, and improper or unreasonable allocation of costs to effluent disposal operations.

III. ADJUSTMENTS

Submission of bills, cost records, and other accounting information related to effluent disposal operations shall not prejudice the right of the State to protest or question the correctness thereof; provided, however, all bills, statements, and other accounting records submitted to the State by Lessee during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the twenty-four (24) month period the State takes written exception thereto and makes claim on Lessee for adjustment or the State is auditing the period in question. No adjustment favorable to Lessee shall be made unless it is made within the same prescribed period. The provisions of this paragraph shall not prevent adjustments resulting from a physical inventory of Controllable Material as provided for in Section VII or fraud.

IV. AUDIT

Lessees shall maintain all records for the Commission to audit for a period of six (6) years. The State shall give

CALENDAR PAGE	89
MINUTE PAGE	569

Lessees thirty (30) days' notice of a proposed audit. Audits shall occur no more frequently than once a year.

V. ALLOWABLE CHARGES

Costs are allowable only for Effluent Disposal Operations as follows:

A. Direct expenses:

Lessees shall debit the State Effluent Disposal Account with the items specified in Paragraph 1.9 below and allocated in accordance with Section C, below.

1. Labor.

a. Salaries and wages of Lessees' field employees directly employed in the conduct of Effluent Disposal Operations.

b. Salaries of First Level Supervisors in the field.

c. Salaries and wages of Technical Employees, temporarily assigned to and directly employed in the conduct of Effluent Disposal Operations.

2. Lessees' cost of holiday, vacation, sickness

CALENDAR PAGE	90
MINUTE PAGE	570

and disability and other customary allowances paid to employees whose salaries and wages are chargeable to the Effluent Disposal Account under Paragraph A of this Section V. Such costs under this Paragraph 2 may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Effluent Disposal Operations under Paragraph 1 of this Section V. If percentage assessment is used, the rate shall be based on the Lessees' cost experience.

3. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Lessees' costs chargeable to the Effluent Disposal Account under Paragraphs 1 and 2 of this Section.

4. Personal Expenses specifically incurred by those employees whose salaries and wages are chargeable to the Effluent Disposal Account under Paragraph 1 of this Section V and for which expenses the employees are reimbursed under Lessees' usual practice.

5. Employee Benefits:

Lessees' current costs of established plans for

CALENDAR PAGE	91
MINUTE PAGE	571

employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Lessees' labor cost chargeable to Effluent Disposal Operations under Paragraphs 1 and 2 of this Section V. Costs under this paragraph may be charged by "percentage assessment" on the amount of salaries and wages chargeable to the Account and shall be based upon operators cost experience.

6. Material:

Material purchased or furnished by Lessees for use in Effluent Disposal Operations. Only such Material shall be purchased for or transferred to the Effluent Disposal Operations as may be required and is reasonably practical and consistent with efficient and economical operations. The accumulation of surplus stocks shall be avoided.

7. Transportation:

Transportation of employees and Material necessary for Effluent Disposal Operations but subject to the following limitations:

- a. If Material is moved for the benefit of Effluent Disposal Operations from the Lessee's

CALIFORNIA PAGE	52
MINUTE PAGE	572

warehouse or other properties, no charge shall be made to the Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.

b. If surplus Material is moved to Lessees' warehouse or other storage point, no charge shall be made to the Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Account for moving Material to other properties belonging to Lessees, unless agreed to by the Parties.

c. In the application of subparagraphs a and b above, there shall be no equalization of actual gross trucking cost of \$200 or less excluding accessorial charges.

3. Services:

The cost of contract services, equipment and

CALENDAR PAGE	93
MINUTE PAGE	573

utilities provided by outside sources, except services otherwise excluded by this paragraph or Section VI. The cost of professional consultant services and contract services of technical personnel directly engaged in Effluent Disposal Operations if such charges are excluded from the Overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged in Effluent Disposal Operations shall not be charged to the Account unless previously agreed to by the State and Lessees.

9. Other Expenditures:

Any other expenditure not covered or dealt with in the foregoing provisions of this Section V.A., and which is incurred by the lessees in the necessary and proper conduct of the Effluent Disposal Operations.

B. Indirect Expense

District Office:

The portion of the costs necessary in maintaining and operating the district office, including the salaries and expenses of district manager, production and drilling superintendents, office clerks, and other employees located in the district, performing district functions

CALENDAR PAGE	54
MINUTE PAGE	574

for the benefit of State Effluent Disposal Operations. Such portion of costs is to be determined based upon time spent to the benefit of the Effluent Disposal Operations as shown on individual employee time allocation reports.

C. Overhead:

1. Overhead-Drilling and Producing Operations
 - a. A charge shall be made to cover any portion of salaries and wages, applicable payroll burden and expenses of any management, supervisory, administrative, accounting, purchasing, tax, insurance, stores, technical, clerical and other employees and officers indirectly serving Effluent Disposal Operations whose salaries, wages and expenses are not a chargeable cost under Section V A. and B.; also, any portion of the expense of maintaining and operating all offices and facilities and other similar facilities not required exclusively for Effluent Disposal Operations with the exception of the portion of the District Office costs and clerical costs which will be charged directly under Section V, paragraph B above, and shall be the sum of a percentage of development and operating charges as determined in paragraph 2 of this Section D.

CALENDAR PAGE	95
MINUTE PAGE	575

b. The salaries, wages and Personal Expenses of Technical employees temporarily assigned to and employees directly employed on or in the conduct of Effluent Disposal Operations and/or the cost of professional consultant services and contract services of technical personnel directly employed in the conduct of Effluent Disposal Operations shall not be covered by the Overhead rates.

2. Overhead-Percentage Basis

a. Notwithstanding that the actual overhead may be greater or less, Lessee shall charge Effluent Disposal Operations at the following rates:

(1) Development

Four percent (4%) of the capitalized cost of development of the Effluent Disposal Facilities shall be debited to the State Effluent Disposal Account. This rate shall also be applicable to special well repairs under paragraph E. 4. of these procedures.

CALENDAR PAGE	36
MINUTE PAGE	576

(2) Operating

Ten Percent (10%) of the cost of conducting Effluent Disposal Operations exclusive of costs provided under Section V B., all salvage credits and all taxes and assessments which are levied, assessed and paid upon Effluent Disposal Facilities.

(3) Ecological and Environmental

Ten Percent (10%) of the costs incurred with respect to requirements, whether statutory or otherwise, relating to the ecology of the environment in the project area and incurred in the conduct of Effluent Disposal Operations.

b. Application of Overhead - Percentage Basis shall be as follows:

For the purpose of determining charges under paragraph 2 of this Section V.D., and if such costs are allowed by section E. 1 of these procedures development shall include all costs in connection with the drilling, redrilling, deepening or any remedial operations on any or all wells involving the use of drilling crew and equipment; also, preliminary expenditures

CALENDAR PAGE	97
MINUTE PAGE	577

necessary in preparation for drilling and expenditures incurred in abandoning when the well is not completed and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset. All other costs shall be considered as Operating.

E. Capital Investment:

Lessees shall debit the Account with the items specified in Section 1 and 2.

1. Injection Wells:

a. The full costs are chargeable to the Account for exploratory or development wells which are dry, and converted to injection wells within five (5) years of completion, and wells initially drilled only for injection service. Such costs shall be charged in the year of conversion.

b. Only the conversion costs are chargeable to the Account for production wells which are converted to injection wells, and exploratory or development wells converted later than five

CALENDAR PAGE	98
MINUTE PAGE	578

(5) year after suspension or abandonment.

2. Other Investments:

a. Investments made to construct pipelines, purchase and/or install pumps, construct effluent disposal facilities, and other charges necessary for the maintenance of such facilities, shall be charged to the Account.

3. Special Well repair costs:

Well repair costs for injection wells are to be charged to the Account as incurred.

4. Property Taxes:

Property taxes attributable to the improvements represented by waste water disposal operations shall be allowable and debited to the account. However, any increase in property taxes created by any purchase, sale, or other acquisition of an interest in the leases are not chargeable

VI. NONCHARGEABLE COSTS

The following costs shall not be charged as Direct or Indirect expenses or Capital investments:

CALENDAR PAGE	<u>90</u>
MINUTE PAGE	<u>579</u>

- A. Direct and Indirect expenses and capital investments incurred for the disposal of non-effluent shall not be charged to the Account.
- B. Undocumented expenses or capital investments, or documented expenses or capital investments which do not benefit Effluent Disposal operations are not chargeable.
- C. Interest on investment, or capital recovery.
- D. The following legal expenses:
 - 1. The costs of litigation against the State of California.
 - 2. Fines or penalties levied by any governmental agency except when the actions subject to fine or penalty are performed at the order of the Executive Officer.
 - 3. Settlement of claims or other litigation resulting from violation of regulatory requirements or gross negligence or willfull misconduct; and
 - 4. The costs of the Lessees' legal staff or expense of outside attorneys.

CALENDAR PAGE	100
MINUTE PAGE	580

E. The Lessees' own cost of administering employee benefit plans.

F. Research and development costs, except that this type of cost shall not be construed to cover the resolution of specific technical problems confronting Effluent Disposal Operations, specific engineering design problems related to equipment or facilities required for Effluent Disposal Operations, or services required to comply with federal, state and local laws or regulations.

VII. INVENTORIES

The Lessees shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation:

At reasonable intervals, Inventories shall be taken by Lessees of the Controllable Material attributable to effluent disposal operations. Written notice of intention to take inventory shall be given the State by Lessees at least thirty (30) days before any inventory is to begin so that the State may be represented when any inventory is taken. Failure of

CALENDAR PAGE	101
MINUTE PAGE	581

the State to be represented at an inventory shall bind the State to accept the inventory taken by Lessees.

2. Reconciliation and Adjustment of Inventories:

Reconciliation of a physical inventory shall be made, and a list of overages and shortages shall be furnished to the State within six months following the taking of any inventory. Inventory adjustments shall be made by Lessees with the Account for overages and shortages, but Lessees shall be held accountable only for shortages due to lack of reasonable diligence.

3. Special Inventories:

Special Inventories may be taken whenever there is any sale or change of interest in the Leases. In such cases, both the seller and the purchaser shall be governed by such inventory.

4. Expense of Conducting Periodic Inventories:

The expense of conducting periodic Inventories shall not be charged to the State Effluent Disposal Account unless agreed to by the Parties.

CALENDAR PAGE	102
MINUTE PAGE	582

There are no pages numbered 103 and 104

CALENDAR PAGE	103-104
MINUTE PAGE	583